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**In the Supreme Court**

OF THE

**United States**

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OCTOBER TERM, 1977

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No. **77-1859**

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JERE N. HEIFAT,  
*Petitioner,*

vs.

SECURITIES AND EXCHANGE COMMISSION,  
*Respondent.*

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**PETITION FOR A WRIT OF CERTIORARI  
to the United States Court of Appeals  
for the Ninth Circuit**

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BURTON J. GOLDSTEIN

RALPH GOLUB

P. M. BARCELOUX

M. REED HUNTER

JOHN J. DACEY

GOLDSTEIN, BARCELOUX & GOLDSTEIN

650 California Street, 33rd Floor

San Francisco, California 94108

*Attorneys for Petitioner.*



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**PETITION FOR A WRIT OF CERTIORARI**

**to the United States Court of Appeals  
for the Ninth Circuit**

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Petitioner Jere N. Helfat prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in this case on February 6, 1978.

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## **OPINIONS BELOW**

The memorandum decision of the District Court, filed March 26, 1976, is appended hereto as Appendix A, pages 1 through 3. The opinion of the Court

of Appeals is appended hereto as Appendix B, pages 4 through 23.

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### **JURISDICTION**

The Court of Appeals entered judgment on February 6, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

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### **QUESTIONS PRESENTED**

The major question presented is:

Shall the standard established by this Court<sup>1</sup> to control review of an exercise of discretion in a Federal District Court to issue or not issue an injunction against prospective violation of federal securities laws, i.e., that such exercise shall be affirmed unless the government demonstrates that there is no reasonable basis for the decision, be modified to extend the power of the reviewing court to substitute its judgment for that of the District Court?

A second question here presented, which may be resolved in this case,<sup>2</sup> is:

Is an injunction against prospective violations of the securities laws an appropriate remedy in a situation where the past violation by the person against whom the injunction is sought was due to mere negligence only?

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<sup>1</sup>In *United States v. W. T. Grant*, 345 U.S. 629 (1953), and elsewhere.

<sup>2</sup>The basis for this qualifying language is set forth at p. 20, *infra*.

## **CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED**

The applicable constitutional and statutory materials are set out in Appendix C, pages 24 through 31.

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### **STATEMENT OF THE CASE**

#### **A. Discovery and Reporting of the Fraud.**

On Friday, August 3, 1973, the executive leadership of Koracorp Industries, Inc. uncovered a major fraud being perpetrated by certain officers and employees of a subsidiary corporation, which significantly distorted Koracorp's financial statement. The situation came to light when Louis Philip Weil (herein "Weil") in effect confessed that he and a number of associates had manipulated the accounts receivable of Koratec Communications, Inc. in such a manner that over five million dollars shown on the books were largely uncollectible and in part nonexistent. The admission was made at a meeting called by Koracorp's president, petitioner Jere N. Helfat (herein "petitioner" or "Helfat"), to determine the reason for this slow-moving accumulation of receivables, and to explore possible ways to expedite collection. Appendix B, pp. 6-7.

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<sup>3</sup>This petition will cite to the opinions below for facts, with comment as necessary. We intend to designate for certification and transmittal, pursuant to Supreme Court Rule 21.1, a limited part of the record, including the complaint, an S.E.C. investigative transcript dealing with Jere N. Helfat (herein "Helfat Transcript"), and two affidavits of petitioner, dated February 12, 1976 (herein "Helfat Affidavit") and March 12, 1976 (herein "Helfat Supplemental Affidavit"). These documents will also be cited.

On the following Monday, this alarming disclosure made by Weil was reviewed by petitioner with other corporate officers and legal counsel. It was then determined that the acts of Weil and his group might involve violations of the Securities Exchange Act of 1934 and other federal securities laws. Pursuant to this conclusion, Koracorp (acting on petitioner's direction) fully and completely disclosed to the Securities and Exchange Commission (herein the "S.E.C.") and the New York and Pacific Coast Stock Exchanges the full particulars of the discovery on August 7th. At the same time, and again on the recommendation of petitioner, Koracorp launched its own investigation of the irregularities which had come to its attention. Helfat Affidavit; C.R. 180-182.

Koracorp Industries, Inc. is a large and highly diversified Delaware corporation whose stock is publicly traded on the New York and Pacific Coast Stock Exchanges. Koratec Communications, Inc. was one of several subsidiaries administered under the umbrella of Koratec Unicenter, directed by Arthur F. Cunningham (herein "Cunningham"), a Vice-President of Koracorp, Inc. Koratec Communications, Inc. (herein "K.C.I.") enjoyed, however, a large degree of autonomy in its actions. Appendix B, pp. 5-7. Helfat, in fact, had virtually no contact with Weil. Helfat Transcript, pp. 25-26.

#### **B. S.E.C. Response.**

Upon receipt of the information of receivables irregularities from the Koracorp management, the S.E.C. suspended all trading in Koracorp securities.

This suspension was lifted in early 1974. (Appendix B, p. 7). By the time the trading reopened, petitioner (Weil's remote supervisor) had resigned as president of Koracorp pursuant to a request of the board of directors. Weil also resigned after request, and Cunningham was ousted as vice-president by the same body.

After his resignation on August 24, 1973, Helfat remained for a period of time with the corporation as a special consultant to the chairman of the board.

After an intense two-year investigation, the S.E.C. filed (under date of November 26, 1975) a complaint (Northern District of California No. 75 2515 SW) against Weil, and others associated with him, charging culpability in the fraudulent receivables debacle. In this action,<sup>4</sup> the S.E.C. also complained against petitioner, Cunningham, Koracorp itself, and Arthur Andersen & Co., a public accounting firm. Although the complaint taints them all with broad conclusionary averments<sup>5</sup> of sundry wrongdoing in its intro-

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<sup>4</sup>The S.E.C. invoked the jurisdiction of the District Court pursuant to Sections 20(b) and 22(a) of the Securities Act of 1933, and Sections 21(d), 21(e) and 27 of the Securities Exchange Act of 1934. Complaint, Appendix A, ¶4-5.

<sup>5</sup>An example of this type of allegation is the language in paragraph 25 of the complaint asserting that *as of its date* (November 26, 1975), petitioner was engaged in security "schemes, artifices and devices to defraud." The S.E.C. has never made, however, a serious effort to prove improper securities activities on the part of petitioner after his resignation in August, 1973. Indeed, as the Court of Appeal opinion notes (Appendix B, p. 10), the S.E.C. agreed "that after the collapse of KCI and the exposure of the fraud, violations ceased". Even by liberal federal pleading standards, this pleading *as fact* statements the S.E.C. clearly knew to be false at the time made, must be characterized as irresponsible and destructive overreaching.

ductory parts, it is clear from the subsequent, more particular, allegations and the course of conduct of the S.E.C. since the complaint was instituted that the essence of the Commission's charge against petitioner was not that he was directly involved as a principal in the fraud, but rather that he (1) failed to disclose to the public when he knew or should have known of Weil's scheme the particulars thereof, and (2) covered up the manipulations to his personal profit.<sup>6</sup> The sole relief sought against petitioner was the imposition of an injunction against further violations of the United States securities laws.<sup>7</sup> After instituting the action, the S.E.C. continued its investigation through formal discovery devices.

#### **C. Summary Judgment Motions.**

In early 1976, motions for summary judgment were filed by various defendants.<sup>8</sup>

In response to these motions, the S.E.C. presented evidence that Weil was the "chief architect of the fraud" and that he and his cohorts caused to be placed and carried upon K.C.I.'s books "millions of dollars of uncollectibles and sometimes wholly ficti-

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<sup>6</sup>Since K.C.I. was a subsidiary of Koracorp whose financial statement was incorporated in its parent corporation, the manipulations of the Weil group caused the profits of Koracorp to be overstated. Helfat, like others in management, received as a part of his compensation package a bonus tied into corporate profit.

<sup>7</sup>The complaint made specific reference to the Securities Act of 1933, as amended, Sections 10(b) and 13(a) of the Securities Exchange Act of 1934, as amended, and Rules 10b-5 and 13a-1 promulgated thereunder.

<sup>8</sup>For purposes of this motion only, petitioner conceded negligence.

tious, accounts receivable." Appendix B, p. 5. Evidence was also presented showing that Weil received kickbacks from parties with whom K.C.I. did business.<sup>9</sup>

The evidence marshalled and presented at the summary judgment hearing showed that Koracorp management first became aware that there might be a problem with K.C.I. receivables in 1971, when Arthur Andersen & Co. inquired as to whether these receivables were being liquidated with sufficient expedition. In response thereto, petitioner ordered an investigation conducted by Ronald McClellan, an outside director of Koracorp and a financial consultant, of these receivables. Following this investigation, McClellan reported that these receivables were good, valid and collectible. Helfat Transcript, p. 32.

As noted in the Court of Appeals opinion (Appendix B, p. 7, ll. 1-3), a further internal investigation was ordered by petitioner in May of 1973, when the situation had not improved in spite of the clean bill of health which had been given in the 1972 McClellan report.

The precise language in the opinion is significant; while it states that by the May 1973 date petitioner was "aware of the receivables debacle" (Appendix B, p. 70), but it fails to note that what he was aware of at that time was merely a large and apparently

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<sup>9</sup>Weil never denied that he received these monies, but chose to characterize them differently than did the S.E.C., and assert that they were properly received.

indigestible accumulation of accounts receivable. Neither of the opinions below state, and the S.E.C. found no evidence to demonstrate, that petitioner was aware of any fraud, manipulative impropriety, or violation of the securities laws, prior to Weil's confession on August 3, 1973.

After careful study of the materials submitted in support of and in opposition to petitioner's summary judgment motion, the United States District Court granted summary judgment to petitioner and certain of the defendants.<sup>10</sup> in a memorandum decision dated March 26, 1976. In so ruling the Court exercised the discretion vested in it by law and held that the S.E.C. had not demonstrated a threat of subsequent violations to justify a prospective injunction. Judge Spencer Williams issued a memorandum decision explaining the reasons for his decision. The specific language of that decision is illuminating. After stating that the S.E.C. had failed to bring forth "hard facts" to demonstrate the need for an injunction, the Court went one specific and significant step further and noted that "no facts have been *alleged* upon which the court could conclude that there is any expectation of future violations, let alone a reasonable one." Appendix A, p. 2. (Emphasis added).<sup>11</sup>

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<sup>10</sup>Weil was not one of the beneficiaries of this ruling, but was later granted summary judgment following a separate hearing.

<sup>11</sup>It is apparent here that Judge Williams was referring to the particular and specific allegations in the complaint, and not broad-brush boilerplate such as that noted in footnote 5, *supra*.

#### **D. Appellate Review.**

Appeal was taken by the S.E.C. against the summary judgments granted in favor of petitioner and other defendants, and consolidated with the summary judgment motion subsequently granted in favor of Weil, and his group. On February 6, 1978, the Court of Appeals for the Ninth Circuit (opinion by the Honorable Shirley Hufstедler, joined by the Honorable Russell E. Smith, chief judge for the United States District Court of Montana, and the Honorable James M. Carter) reversed all of the summary judgments except that granted to Arthur Andersen. Justice Carter wrote a concurring opinion. Thereafter, timely petitions for reconsideration were filed by Koracorp and petitioner Jere N. Helfat. Through an order filed May 24, 1978, the Court of Appeals denied both petitions.

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### **ARGUMENT IN SUPPORT OF ALLOWANCE OF WRIT**

- I. IN SEVERELY LIMITING THE DISCRETION OF A DISTRICT COURT TO ISSUE OR WITHHOLD AN INJUNCTION AGAINST PROSPECTIVE VIOLATIONS OF THE FEDERAL SECURITIES LAWS, THE NINTH CIRCUIT HAS RESOLVED A FEDERAL QUESTION IN A MANNER IN MARKED CONTRAST WITH APPLICABLE DECISIONS OF THIS COURT.**
- A. The Broad Equitable Discretion Vested in a District Court, As Defined By This Court.**

The standards governing the discretion of a district court judge in granting or refusing to grant an injunction against future violations of law have been clearly delineated by this Court. A leading case, re-

lied on by both petitioner and the S.E.C., and cited in both opinions below, is *Hecht Co. v. Bowles*, 321 U.S. 321 (1944).

In *Hecht*, as here, high corporate officers were brought into court by a federal agency to restrain them from future violations of a government legislative and regulatory scheme (the Emergency Price Control Act). After concluding that the "mistakes . . . were all made in good faith and without intent to violate the regulations" (321 U.S. at 525), this Honorable Court analyzed the nature of the injunctive enforcement remedy. A distillation of that analysis, insofar as here pertinent, is that this remedy did not spring full blown from the head of the federal bureaucracy, but rather came into modern governmental law "with a background of several hundred years of history" (321 U.S. at 329) in equity practice. This Court discussed the discretion vested in chancellors in equity to tailor relief to particular situations, without being unduly stymied by rigid precedent:

"The historic injunctive process was designed to deter, not to punish. The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case. Flexibility rather than rigidity has distinguished it." 321 U.S. at 329.

Another case which was central to the briefing and argument at both levels below was *United States v. W. T. Grant*, 345 U.S. 629 (1953). The statutory context of that case differed from the instant case (the

provisions of the Clayton Act of 1974 which prohibited interlocking directorates), but the relief sought was identical. In language strongly reminiscent of the language in Judge Williams' opinion quoted on page 8, *supra*, the District Court which ruled initially in *W. T. Grant* concluded that there was not "the slightest threat that the defendants will attempt any future activity in violation of §8 . . ." 345 U.S. at 631. In rejecting the contention that the District Court judge had abused its discretion, this Court again discussed the nature and utility of the injunctive remedy. Reaffirming that "the purpose of injunctions is to prevent future violations" (345 U.S. at 633), this Court made clear that an injunction may lie in particular circumstances without a showing of past wrongs, or be rejected in other circumstances when a showing of past wrongs is present, since the *sine qua non* is a reasonable threat of future infractions. The Court stated "[t]he chancellor's decision is based on all the circumstances; his discretion is necessarily broad and a strong showing of abuse must be made to reverse it." (Emphasis added.) In setting forth pertinent criteria the court stated them to be "the bona fides of the expressed intent to comply, the effectiveness of the discontinuance and, in some cases, the character of the past violations." 345 U.S. at 633.

In *United States v. W. T. Grant*, in marked contrast to this case, the defendant had refused repeated administrative efforts to terminate the wrongful acts. In view of this and other facts, this Court suggested

that were it sitting as a trial court, it might have been persuaded to issue an injunction. Nonetheless, the Court articulated its hesitation to substitute its discretion for that of the district court judge, and affirmed the District Court. The opinion then set forth the burden placed upon the government agency seeking to undo a district court decision denying an injunction:

“[T]he government *must* demonstrate that there was *no reasonable basis* for the District Judge’s decision.” 345 U.S. at 634. (Emphasis added.)

Neither the historical background of the vestiture of chancellors in equity with broad discretion nor the value thereof to the administration of justice, need be explored in detail at this point. This utility, however, is menaced by the decision of the Ninth Circuit in this case, which is irreconcilable with the holdings of this Court, and insensitive to the sound policies underlying these holdings.

**B. The Equitable Standard Vested in the District Court, As Defined By the Ninth Circuit.**

The United States Court of Appeals for the Ninth Circuit showed none of the reticence to overturn a district court judge in this case that graced the consideration of this Court in *United States v. W. T. Grant*. It required no strong showing by the government; indeed, it required no showing of substance *at all*. Early in the opinion (Appendix B, pp. 11-13) the Court of Appeals improperly shifted the burden of persuasion on petitioner and the other defendants.

While giving lip service to the proposition that the controlling factor should be the threat of future violations (Opinion, Appendix B, p. 11), it nevertheless concentrated solely on one part of the three-pronged formula above quoted, and (if the language of this Court is to be taken literally) the least significant of these factors, i.e., past violations.

While some parts of the opinion, considered in isolation, would appear to belie this statement, it seems clear when the opinion is ingested as a whole that the Court of Appeals lost sight of the fact that it was reviewing a summary judgment granted on the limited issue of whether there were sound grounds to prospectively enjoin petitioner and the other defendants from future violations of securities laws, and not considering the quite different question whether they were culpable for negligent or intentional misconduct in the past. Judge Williams did not pronounce the defendants clean; he merely ruled on the appropriateness of one particular remedy.

However, it may be noted that even if the motion before the court had truly been what the court erroneously perceived it as being, i.e., a question of whether petitioner acted with scienter, affirmance would still have been mandated. The record simply does not support anything beyond the conceded negligence. It is significant that the opinion of neither the District Court nor the Court of Appeals contains any recitation of specific facts which were *proven* by the S.E.C. to support its allegations that petitioner was

guilty of fraud, bad faith, aiding and abetting, etc.<sup>12</sup> At the beginning of the lawsuit, the S.E.C. made serious allegations against petitioner. After the intensive intervening discovery,<sup>13</sup> it was still relying on such allegations. The S.E.C. contentions against this petitioner (as distinguished from some of the other defendants) rest on remote chronological relationship, unlikely inference, and improbable supposition. Neither opinion suggests that the allegations against Jere N. Helfat were *factually* substantiated.<sup>14</sup>

It is apparent from the majority opinion (see Appendix B, particularly pages 14-16) that the Ninth Circuit was primarily (and quite understandably) concerned by the fact that financial manipulations of a highly dubious nature had gone on within the corporate structure of Koracorp, and yet each of the parties charged with active wrongdoing or complicity had successfully resisted the S.E.C.'s attempt to impose injunctions. This result is not, upon reflection, as disturbing as it might initially seem,

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<sup>12</sup>It is apparent that there is a problem of citation and proof in connection with this assertion. The only way this Court can verify the *absence* of sufficient evidence in the record to justify reversal is to examine the entire, extensive record (thousands of pages). This sheer bulk of the record makes this impractical at this juncture. Accordingly, petitioner simply challenges the S.E.C., in its reply to this petition, to bring to the attention of this Court actual hard evidence of scienter or cognizant, deliberate fraud in the record which supports its charges against petitioner.

<sup>13</sup>The fact that there has been ample opportunity for discovery and that the S.E.C. has been unable to uncover any actual evidence of any affirmative wrongdoing by Helfat is in itself a compelling argument for the District Court's ruling. See *Willmar Poultry Co. v. Morton-Norwich Products, Inc.*, 520 F.2d 289, 293 (8th Cir. 1975).

<sup>14</sup>This is considered more fully on pp. 23-26, *infra*.

since the question before the District Court was not whether past violations had occurred, but whether, considering all applicable circumstances and facts, a threat of future violations of such magnitude existed to justify the remedy sought.

The court, in effect, sent the matter back for a sorting-out process, pursuant to which the sheep might be separated from the goats, or (more precisely) the violators from the non-violators. What seems to have escaped the notice of the court is that this sorting out process had already been in large measure accomplished by the S.E.C. through its internal processes, and by all parties through discovery and production of documents for the summary judgment proceeding. As the Court of Appeals noted, "[a]c-  
cording to evidence presented by the S.E.C., Weil was the chief architect of the fraud." Opinion, Appendix B, p. 5. The S.E.C. had taken the same position in its briefs and memoranda.<sup>15</sup>

While the efficient administration of justice is furthered generally by consolidations of cases which present common or closely related questions of law, it is apparent that the interests of petitioner in this case were ill-served by consolidating his appeal with that of Weil, the actual miscreant. It is respectfully submitted that consideration in the aggregate of the charges against all the defendants could not have helped but distort the perspective of the Court.

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<sup>15</sup>For example, it refers to Weil as "the principal architect of the fraud" in both its brief filed in October 1976 (p. 4), and its brief filed in February 1977 (p. 5).

Not only is the majority Ninth Circuit decision insensible to the equities of the case, it is an invitation to further and extended judicial proceedings that will be totally futile.

The Memorandum Decision filed March 26, 1978, fails to analyze and appreciate the thrust and content of the opinion of the District Court.<sup>16</sup> As noted in the statement of facts, a careful analysis of the wording of that document leads inevitably to the conclusion that it stated, alternatively:

(1) the S.E.C. had not proven facts that would support an expectation of further violations of the securities laws justifying imposition of an injunction, and *further*

(2) "no facts have been *alleged*" which would support such issuance, i.e., that even if the S.E.C. had proven its entire theory, the relief sought would still be inappropriate.

If the District Court is to be taken on its word, the outcome of the extended hearing is a foregone conclusion. Even if the S.E.C. succeeds in producing evidence to support its most extravagant allegations (which it will not), the Court will reach the same result as it earlier reached, and the case will be back before the appellate court in the same posture several months hence.

Thus, in spite of (1) the lack of *any* evidence demonstrating cognizant impropriety, (2) petitioner's role

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<sup>16</sup>The concurring opinion of Justice Carter demonstrates his awareness of the problem. See p. 29, *infra*, for a consideration of that opinion.

in exposing and reporting the problem, (3) the dearth of any evidence (or even claim) that petitioner had violated the securities laws (or any other laws) prior to the onset of the situation which is the subject matter of this action, and (4) the specific finding of no threat whatsoever of future violations, the Ninth Circuit held that the S.E.C. had made the strong showing of abuse necessary to reverse the trial court's ruling, and that there was "no reasonable basis" for its decision. This holding is, quite simply, inexplicable.

**C. Not Only Is the Ninth Circuit Opinion Inconsistent With Controlling Decisions of This Court, It Is Internally Inconsistent With Itself.**

After ignoring in a strikingly cavalier manner the principles enumerated in *United States v. W. T. Grant, supra*, in that part of the opinion dealing with petitioner and certain other defendants (Appendix B, pp. 10-16), the court rediscovered these principles in its consideration of the summary judgment motion granted in favor of Arthur Andersen & Co. (Appendix B, pp. 16-22). There, it recognized the broad discretion vested in the district court acting as a chancellor in equity. It correctly noted that past violations do not mandate the issuance of an injunction and that "[t]he critical issue is that there is a reasonable likelihood that the wrong would be repeated. The district court has a significant degree of latitude in making that determination." Opinion, Appendix B, page 21. It says, in fact, all the right things. It is soundly reasoned and attractively written. One could not wish for a more ringing reaffirma-

tion of the principles that control this type of proceeding as articulated by this Honorable Court. However, this restoration of the mantle of discretion to the district judge which had been earlier wrested from his shoulders does not cure the prior error. It merely makes the second part of the opinion completely inconsistent with what preceded it.<sup>17</sup> It was in fact an abuse of its powers and discretion for the Ninth Circuit to hold, on the one hand, that the trial court properly exercised its discretion in granting the summary judgment motion of Arthur Andersen & Co. and at the same time reversing the summary judgment in favor of petitioner, when such factual similarity is present.

There are some rather obvious differences between the *formal* posture of petitioner and Arthur Andersen & Co. before the Court. Petitioner was a part of the corporation's internal management team, and Arthur Andersen was an outside observer. The *real* posture of petitioner and Arthur Andersen in this case, however, is in substance comparable. Each was remote from the actual wrongdoing. Each, according to the S.E.C., saw or should have seen red flags which should have prompted an in-depth investigation which, we are informed, would have promptly exposed the miscreants.<sup>18</sup> Each conceded negligence for purposes of argument at the time of the summary judgment

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<sup>17</sup>This inconsistency was the subject of the petition for rehearing filed by Koracorp.

<sup>18</sup>The fact the earlier investigations did not unearth the scheme is overlooked in this contention.

motions.<sup>19</sup> Each was charged by the S.E.C. with wrongdoing *beyond* negligence. In each instance (as the opinions of the courts below confirm by both what they contain and what they do not contain) the S.E.C. was unable to substantiate its charges of intentional wrongdoing with supportive hard evidence, in spite of the years of discovery which antedated the summary judgment motions.<sup>20</sup>

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**II. THIS COURT SHOULD FINALLY SETTLE THE QUESTION OF WHETHER THE IMPOSITION OF AN INJUNCTION AGAINST PROSPECTIVE VIOLATIONS OF SECURITIES LAWS AND REGULATIONS IS APPROPRIATE WHERE PAST VIOLATIONS HAVE NOT BEEN INTENTIONAL, BUT MERELY NEGLIGENT. THIS CASE PRESENTS A VEHICLE FOR SUCH RESOLUTION.**

**A. Introduction; Nature of Issue Presented.**

Point I addresses the presence of a decision of a court of appeal resolving "a federal question in a way in conflict with applicable decisions of this Court" (Rule 19(b), Supreme Court Rules) in this case.

In this point, that part of Rule 19(b) describing the presence of "an important question of federal law

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<sup>19</sup>There is one difference here, and that is that Andersen and the Commission virtually adopted each other's factual statements. While the S.E.C. did not adopt Helfat's statement of facts in its motion for summary judgment, it failed to refute any of the material facts stated therein with real evidence. The difference between (a) not attempting to controvert a statement of facts, and (b) attempting but totally failing to controvert facts, is not, it is submitted, significant in the context of this summary judgment motion and appellate review.

<sup>20</sup>As to charges against Arthur Andersen in addition to negligence, see Appendix B, pages 17-20.

which has not been, but should be, settled by this court" is involved.

As noted in that part of this petition delineating the questions presented for review, there is a caveat here. The bases thereof are two-fold:

- 1) This Court may, if it desires, avoid resolution of this question and decide the case (as did the Court of Appeals in its review of the Arthur Andersen decision) on the more limited ground that the District Court acted within its discretion;

- 2) It must be stated, in candor, that the S.E.C. will almost certainly dispute petitioner's assertion that this issue is squarely presented in this case.

While this dispute is clearly something which lends itself to detailed consideration in the brief on the merits provided for in Supreme Court Rule 41, a concise summary here seems inevitable and is the subject of Point II.B., *infra*.

It is one of the worst-kept secrets of the securities bar that the S.E.C. is becoming increasingly enamored of the injunctive remedy. We do not address the intrinsic worth of this enforcement device in cases of deliberate malfeasance, where it might arguably be remedial. On the other hand, singleminded pursuant of an injunction, looking neither to the right nor to the left, where no cognizant wrongdoing was involved and where the injunction almost by definition will have no deterrent effect whatsoever, is a flagrant waste of court time and taxpayer money. Decisional law is not clear as to when pursuit of this remedy

is and when it is not permissible. This case will give the Court an opportunity to draw meaningful guidelines.

*Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) held that in the absence of scienter, a private civil damage suit will not lie under Section 10b of the Securities Exchange Act of 1934 and Rule 10b-5.<sup>21</sup> While it did not specifically address the propriety of injunctive relief where only negligence is present, the same logical and policy grounds on which *Ernst & Ernst v. Hochfelder* is grounded suggest that such relief is inappropriate. Some courts have adopted this extension. See, e.g., *Securities and Exchange Commission v. Bausch & Lomb, Inc.*, 420 F.Supp. 1226 (S.D. New York 1976).

The same rationale which quickened *Ernst & Ernst v. Hochfelder* surfaced again recently in *Santa Fe Industries, Inc. v. Green*, ..... U.S. ...., 97 Sup.Ct. 1292 (1977). The interpretation given to §10(b) and Rule 10b-5 in that case cannot be reconciled with the position the S.E.C. has taken in the case at bar.

In spite of these cases, and the sheer illogic of formal prospective restraint from negligent acts, the S.E.C. took the position in this case (as it has in many others) that injunction relief is an appropriate remedy where simple negligence is presented. Appendix B, p. 20.

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<sup>21</sup>The fact that *Ernst & Ernst* dealt with an outside auditor, rather than a corporate office remote from the wrongdoing, does not seem significant in policy terms.

**B. The "Evidence" Marshalled by the S.E.C. in Opposition to Petitioner's Summary Judgment Motion Was Insufficient to Meet the Standards of Rule 56(e), Federal Rules of Civil Procedure and Consists Solely of Naked Supposition, Innuendo Founded on Chronology and the Unsupported Allegations in the Complaint.**

**1. The Standard.**

Rule 56(e) Federal Rules of Civil Procedure provides:

"(e) When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, *must set forth specific facts* showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him." (Emphasis added.)

A recent federal district court opinion described the responsibility of a party opposing summary judgment under Rule 56(e) to produce "detailed and precise"<sup>22</sup> facts as follows:

"... He must respond with substantial and concrete particulars to establish that there is a genuine issue for trial; general assertions are inadequate. [citations omitted]" *Upper W. Fork River Watershed v. Corps of Engineers*, 414 F. Supp. 908, 914 (D.W. Va. 1976).

As this Court stated in a similar frame of reference in *United States v. W. T. Grant Co.*, *supra*: "[S]ome-

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<sup>22</sup>*Liberty Leasing Co. v. Hillsum Sales Corporation*, 380 F.2d 1013 (5th Cir. 1967).

thing more [is required] than the mere possibility which serves to keep the case live." (345 U.S. 633).

## 2. The "Evidence" Offered by the S.E.C.

The "facts" on which the S.E.C. relied in resisting summary judgment lend themselves to classification into somewhat imprecise, but pragmatically useful, categories. They are as follows:

(1) Circumstances of physical and temporal proximity from which scienter or affirmative wrongdoing is simply assumed.<sup>23</sup> In place of the "substantial and concrete particulars [required] to established that there is a genuine issue for trial,"<sup>24</sup> the S.E.C. makes its case "only on suspicion and on a gossamer inference drawn from the mere sequence of events."<sup>25</sup>

(2) Allegation of cause-and-effect relationship between petitioner's bonus compensation and the inflated receivables from which guilt is inferred.<sup>26</sup> Each of

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<sup>23</sup>The cardinal argument in this category is that since Weil and his group were under petitioner's ultimate control, petitioner just *must* have known that the receivables were spurious. There is no affirmative evidence whatsoever that prior to August 3, 1973, petitioner knew that these receivables were the result of fraudulent financial manipulations.

<sup>24</sup>*Upper W. Fork River Watershed v. Corps of Engineers*, 414 F.Supp. 908, 914 (D.W. Va. 1976).

<sup>25</sup>*Waldron v. British Petroleum Co.*, 38 F.R.D. 170 (S.D.N.Y. 1965), *aff'd sub nom. First National Bank of Arizona v. Cities Service Co.*, 391 U.S. 253 (1968).

<sup>26</sup>The main accusation here seems to be that petitioner benefited from the defalcation since the misdeeds inflated the profit of Koracorp and petitioner's bonus was based in part upon such profit. The inherently unbelievability of a contention that petitioner would risk (1) his whole financial future, (2) his reputation, (3) the future and financial stability of the corporation over which he presided and in whose well-being he had a continuing interest, (4) criminal prosecution and (5) the institution

the contentions (and they are no more than that) extrapolated from the record “by its nature is so incredible as to be unacceptable by reasonable minds, . . .”.<sup>27</sup>

(3) Evidence and conjecture relating to the question of whether petitioner was negligent. Since negligence was conceded, this material was redundant, irrelevant and affirmatively confusing.

(4) Bare allegations, with no attempt to present buttressing data.

(5) A challenge to credibility, i.e., Helfat says such-and-such, we don't believe him, and therefore there is an issue of fact. The profession of disbelief itself becomes a substitution for evidence. This seemed

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of civil actions which might seek damages in astronomic sums, for a few additional bonus dollars, does not seem to bother the S.E.C. in the slightest.

Nor does the S.E.C. seem concerned that the logical basis of this argument is inconsistent with the logical basis of the alternative argument that petitioner should have discovered the fraud earlier. According to that argument, (encompassed in the first of the five categories delineated in the text), petitioner should have discovered the wrongdoing because the magnitude of the problem made it apparent what was going on. By this argument, in contrast, it is suggested the defalcation was so sophisticated and difficult to detect that petitioner had confidence it would *not* be uncovered, and acted accordingly.

The S.E.C.'s inconsistent and ultimately irrational position on this point tends to cloud a distinction that is clear on the record as to petitioner's knowledge of the receivables problem prior to and after August 3, 1973. Before Weil's admission, Helfat regarded the high receivables as a cash flow problem of considerable magnitude, and addressed it in the way that one would expect such a problem to be addressed by top corporate management. However, it was only after August 3 that petitioner knew (or indeed had any reason to suspect) that deliberate wrongdoing was involved.

<sup>27</sup>*Molinos de Puerto Rico, Inc. v. Sheridan Towing Co.*, 62 F.R.D. 172 (D. Puerto Rico 1973).

to make an impression on the Court of Appeals, and thereto compels more than passing mention.

The material in the Court of Appeals opinion addressing the importance of an evidentiary hearing to establish credibility (Appendix B, pp. 15-16) articulates sound law in the abstract, but law which is not applicable to this situation. It is axiomatic that weighing credibility is a major role of a trier of fact. However, it comes into play *only* when *evidence* conflicts with *evidence*. A challenge to evidence by a protestation of disbelief, or by an unsupported inconsistent accusation, does not negate the evidence (unless such evidence is inherently unbelievable), or raise a question of fact requiring resolution by a trier of fact. The essence of a summary judgment proceeding (as opposed to a motion to dismiss for failure to state a claim for relief, or such state-court procedures as the demurrer) is that it is *evidentiary*. Sworn affidavits of fact and other relevant documents are rebutted with sworn affidavits and other documents, making possible summary adjudication on the question of whether *factual* controversy exists. This is what Rule 56(e) contemplates, and this is where the S.E.C. presentation was abjectly inadequate.

None of the categories above described encompass real factual evidence of the type a party resisting summary judgment must present. The S.E.C. presented no real evidence as to scienter and had none to present. Each of the circumstances on which it relied as a foundation for an inference of possible wrongdoing lends itself reasonably and naturally to

an alternative explanation offered, totally inconsistent with the S.E.C.'s position, and readily comprehensible in terms of business management.

When, after extensive discovery including depositions of the movant-party, the plaintiff places his reliance on the "substantial hope that he can produce evidence at the trial,"<sup>28</sup> the trial court is justified in concluding that a trial "would develop no further facts which would in any way alter [the court's] decision."<sup>29</sup> That is the situation here.

**C. While This Court Might Sidestep This Issue and Resolve the Case on Other Grounds, The Issue is Framed in This Case and Should Be Decided By This Court.**

In the majority opinion (Appendix B, pp. 20-21), the Court of Appeals refers to the question of the appropriateness of injunctive relief "against an independent auditor who was guilty of simple negligence" as "specifically left open" in *Ernst & Ernst v. Hochfelder, supra*. This is encompassed within the larger question here framed, which is as to the appropriateness of this remedy in a federal securities law context in the event of simple negligence by any party.

This Court could clearly avoid resolution of this issue and decide the case on the ground the District Court acted within its discretion under all facts and circumstances involved, just as the Court of Appeals

<sup>28</sup>*Chapman v. Rudd Paint & Varnish Co.*, 409 F.2d 635, 643 (9th Cir. 1969).

<sup>29</sup>*United States Jaycees v. San Francisco Junior Chamber of Commerce*, 354 F.Supp. 61, 69 (N.D. Cal. 1972), *Peter J. Allen Corp. v. California Furniture Shops, Ltd.*, 344 F.Supp. 437, 441 (N.D. Cal. 1972).

decided the Arthur Andersen appeal. However, it is strongly urged that this avoidance would be against the interests of the American bench and bar (however laudable the principle of judicial reticence might be in the abstract) for reasons that will hereinafter be made clear.

**D. Issuance of an Injunction Has No Curative Dimension Where Negligence Only Is Involved.**

Petitioner has consistently taken the position throughout these proceedings, and will assertively contend in his brief hereinafter filed in the event this petition is granted, that the imposition of an injunction against a party whose sole culpability is negligence is without value, and in fact affirmatively harmful.<sup>30</sup>

It is not contended that the securities laws may not be negligently infringed. It is suggested only that the injunction remedy is extraordinarily ill-suited for this situation.

The S.E.C.'s major responsibility, as charged by the Congress and the people of this country, is to act as a watchdog over the securities industry to police it against those who would misuse or manipulate securities or investors wrongfully to their own profit. In cases of repeated cognizant violations of law, an injunction—either alone or in tandem with other

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<sup>30</sup>The term "negligence" as used herein does not include those states of mind or behavior known in the law as recklessness or gross, wilful or wanton negligence. These connote cognizant wrongdoing or utter abandonment of reasonable behavior. These present a special situation, in which each case might be best addressed on an *ad hoc* basis. This situation is not presented in this case.

remedies—can serve a useful purpose. It is illogical, however, to purport to enjoin individuals or organizations which have allegedly violated securities law through negligence from such future violations, since they did not deliberately err in the first place. One might just as well enjoin an individual from forgetting his wife's birthday. If human error could be eliminated by injunction we would indeed be at the very gates of paradise. An injunction based on or prohibiting negligence would have no deterrent effect. Its imposition would be a meaningless charade from the point of view of securities violations, and would be punitive in nature, seriously impairing the reputation and ability to earn a livelihood of a person who is guilty of no deliberate wrongdoing.

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**III. DEFINITIVE ADDRESS OF THE ISSUES FRAMED WOULD EFFECT A SUBSTANTIAL SAVING IN JUDICIAL TIME AND ENERGY, AND SERVE THE ADMINISTRATION OF JUSTICE.**

**A. Reaffirmation of the Principle of District Court Discretion Will Facilitate Focused Appellate Review.**

In its erroneous opinion, the Ninth Circuit Court of Appeals has clouded the clear direction this Court gave in *Hecht Co. v. Bowles*, *supra*, *United States v. W. T. Grant Co.*, *supra*, and other cases. Under the Ninth Circuit opinion, the S.E.C. gets virtually a *de novo* hearing, with the Circuit Court independently exercising its judgment, rather than the limited review to determine the existence or non-existence of a reasonable basis for the District Court's ruling, as this Court has repeatedly directed. This decision

will complicate proceedings before, and increase the burden upon, all courts reviewing a denial or granting of an injunction in cases involving alleged violations of not only federal securities laws, but a plethora of other statutory and regulatory provisions.

In his concurring opinion, Justice Carter recognized the very real threat to valuable judicial time in this and comparable cases particularly where (as here) it appears that the district court will exercise its discretion as it did before and deny injunctive relief again following the hearing for which the case is remanded.<sup>31</sup>

**B. A Particularly Significant Dispensation of Judicial Time and Energy Will Result If This Court Rules That An Injunction Does Not Lie Where Negligence Alone Is Involved.**

In view of the demands which are increasingly made upon federal courts and officials, it seems difficult to justify the expenditure of hundreds of hours of lawyer and court time in pursuit of a form of pseudo-relief without prospective deterrent effect. For the

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<sup>31</sup>However sound Judge Carter's prospective analysis of the case might be, and however appropriate his sensitivity to the realities of federal practice, the specific course of resolution proposed by him is hardly feasible. He suggests that the individual defendants admit, for purposes of the summary judgment motion only, all of the specific *charges* set forth in the complaint as restated in the majority opinion (Appendix B, pp. 22-23) and then permit the judge to re-enter the summary judgment. While this course is not without pragmatic appeal, it is quite understandable that a lay person such as petitioner, not schooled in the intricacies of the law, might not be easily persuaded to go into court and confess, even for a limited purpose, to an imposing variety of misdeeds of which he is actually innocent. This would further a belief (already asserted by some critics) that our courts are too often engaged in playing intricate games rather than in a real search for truth.

reasons heretofore stated, this is the intolerable situation that presents itself when the S.E.C. seeks injunctive relief against parties who have been merely negligent.

This extravagantly inappropriate remedy is being repeatedly and resolutely pursued, and such pursuit will cease only when this Court makes it unprofitable.

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### CONCLUSION

For all the foregoing reasons this Court should grant a writ of certiorari to review the decision below.

Dated, San Francisco, California,

June 28, 1978.

Respectfully submitted,

BURTON J. GOLDSTEIN

RALPH GOLUB

P. M. BARCELOUX

M. REED HUNTER

JOHN J. DACEY

GOLDSTEIN, BARCELOUX & GOLDSTEIN

*Attorneys for Petitioner.*

(Appendices Follow)